Supreme Court, U.S.
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No.

In the

Supreme Court of the United States

YEAGLE DRYWALL COMPANY, INC.,

Petitioner

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

PETITION FOR A WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE THIRD CIRCUIT

PETITION FOR WRIT OF CERTIORARI

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24 pp

QUESTIONS PRESENTED

1. Does the label "officer," adopted by an individual who is the 99 percent shareholder and president of an S corporation, require such individual to be treated as an employee of the S corporation, based on a narrow and exclusive reading of 26 U.S.C. Sec. 3121(d)(1)?

2. Is the "employment status" definition in Section 530(c)(2) of the Revenue Act of 1978 suspended by Treasury Regulation 31.3121(d)-1(b), a non-legislative published interpretation of the Internal Revenue Service?

3. Are the instructions as to the character of income passed through to a shareholder of an S corporation, as contained in 26 U.S.C. Sec. 1366(b), suspended by 26 U.S.C. Sec. 3121(d)(1) when an S corporation shareholder labels himself or herself as an "officer?"

4. Does a reasonable basis exist to not treat an individual as an employee of an S corporation, when no employer-employee relationship ever existed under the usual common law rules between an S corporation and its 99% shareholder and president who is the individual not treated as an employee?

5. Is a taxpayer's due process violated when the Section 530(e) of the Revenue Act of 1978 written notice of the provisions of that Act are never provided by the Internal Revenue Service to a taxpayer which has been subjected to an employment tax audit inquiry by the I.R.S. regarding one or more individuals who perform services for the taxpayer, such as an "officer" of an S corporation?

CORPORATE DISCLOSURE STATEMENT

The Petitioner: YEAGLE DRYWALL COMPANY, INC., a Pennsylvania corporation.

YEAGLE DRYWALL COMPANY, INC., the petitioner, is a nongovernmental corporate party to the proceedings and was a party to the proceedings as the "Petitioner" in the United States Tax Court and the "Appellant" in the United States Court of Appeals for the Third Circuit.

YEAGLE DRYWALL COMPANY, INC. does not now have nor has ever had any parent or subsidiary corporations, and it is not now nor ever has been the parent corporation of another corporation nor has it ever been a subsidiary corporation of another corporation.

No publicly held corporation nor any other corporation owns or ever has owned 10 percent or more of the stock of YEAGLE DRYWALL COMPANY, INC..

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IN THE
SUPREME COURT OF THE UNITED STATES

YEAGLE DRYWALL COMPANY, INC.,
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V.

COMMISSIONER OF INTERNAL REVENUE,
Respondent

PETITION FOR A WRIT OF CERTIORARI TO
THE UNITED STATES COURT OF APPEALS
FOR THE THIRD CIRCUIT

YEAGLE DRYWALL COMPANY, INC., Petitioner, by undersigned cousel, under appropriate rules of this Court, request that this Court issue a writ of certiorari to the United States Court of Appeals for the Third Circuit.

OPINIONS BELOW

This case involves petitioner's challenge of a "Notice of Determination Concerning Worker Classification Under Section 7436" (Notice of Determination) served by respondent upon petitioner on February 23, 2000.

Petitioner timely filed its petition in the United States Tax Court which assigned docket number 3908-00 to petitioner. Petitioner subsequently filed its appeal from the Tax Court decision entered October 16, 2001, based on the Tax Court's memorandum opinion, T.C. Memo. 2001-284, dated October 15, 2001, to the United States Court of Appeals for the Third Circuit and was assigned No. 02-1132 in the Third Circuit. The Third Circuit issued its opinion in petitioner's appeal on December 18, 2002; wherein the Third Circuit combined petitioner's case with another appellant, Veterinary Surgical

Consultants, P.C. (VSC), Third Circuit Appellant No. 02-1214, which also sought an appeal from the Tax Court also concerning the challenge of a Notice of Determination sent to VSC on November 17, 1998.

Petitioner and VSC then filed a joint petition for rehearing en banc with the Third Circuit; the said petition for rehearing en banc was subsequently denied by the Third Circuit on March 5, 2003. All opinions, decisions, judgments, and orders in the lower courts in this case have been reproduced in the Appendix which is being simultaneously filed with this petition.

A petition for a writ of certiorari to this Court for VSC is also being filed with this Court. The governing legislation in both this case and that of VSC involves the Internal Revenue Code (Title 26 of the United States Code) and relevant parts of Section 530 of the Revenue Act of 1978 which have also been reproduced, in pertinent part, in the Appendix.

A CONCISE STATEMENT OF THE BASIS FOR JURISDICTION IN THIS COURT

The date the judgment of the United States Court of Appeals for the Third Circuit sought to be reviewed was entered December 18, 2002 (App.: p. 11a).

The date of the order by the United States Court of Appeals for the Third Circuit denying petitioner's petition for rehearing en banc was March 5, 2003 (App.: pp. 21a & 22a) and the "formal mandate" of the Third Circuit in this case was dated March 13, 2003 (App.: p. 11a).

Jurisdiction is conferred on this Court under 28 U.S.C. Sec. 1254(1).

RELEVANT PROVISIONS INVOLVED IN THE CASE

I. Statutes:

A. 26 U.S.C. Sec. 1366 (App.: pp. 23a & 24a)
B. 26 U.S.C. Sec. 3121(d)(1) (App. p. 24a)
C. Section 530 of the Revenue Act of 1978 (App.: pp. 25a & 26a)

II. Non-legislative Internal Revenue Service Revenue Procedure and Treasury Regulation:

A. Revenue Procedure 85-18 (App.: p. 27a)
B. Treasury Regulation 31.3121(d)-1(b) (also known as "26 C.F.R. 3121(d)-1(b)) (App.: p. 5a)

STATEMENT OF THE CASE

Petitioner is a Pennsylvania corporation which incorporated on October 2, 1989. Petitioner timely elected and was approved for subchapter "S" corporation (S corp.) status by the Internal Revenue Service (IRS) beginning with 1989 and all subsequent years, including 1995, 1996, and 1997, subjecting petitioner to the pass-through rules of 26 U.S.C. Sec. 1366.

Since its incorporation, petitioner has been in the business of drywall construction which was the sole source of petitioner's income. All during 1995, 1996, and 1997, John G. Yeagle (Mr. Yeagle) owned 99 percent of petitioner's stock, and Terree O. Yeagle (Mrs. Yeagle) owned the remaining 1 percent. Since its incorporation, Mr. Yeagle has been petitioner's president and treasurer, and Mrs. Yeagle has been petitioner's vice president and secretary.

Petitioner and Mr. & Mrs. Yeagle, who file their Federal tax returns Forms 1040 as joint filers, filed their Federal tax returns Forms 1120S (of petitioner) and Forms 1040 (of Mr. & Mrs. Yeagle) in a manner consistent with the S corp. pass-through rules to its shareholders in

conformity with the provisions of 26 U.S.C. Sec. 1366; i.e., the character of the gross receipts of petitioner retained the same character of petitioner's net income distributed to Mr. & Mrs. Yeagle and reported by them on their personal Federal tax returns as nonpassive income from an S corp. for each year since petitioner's incorporation. The income received and recorded by petitioner was never received by petitioner as "wages" due to an employee from an employer. There was never any such employer-employee relationship between petitioner and any of petitioner's customers, even though the income received by petitioner was based on the work performed by Mr. Yeagle and his helpers who were all paid by petitioner as independent contractors. Mr. Yeagle reported 99 percent of petitioner's total net income each year, including the years 1995, 1996, and 1997, not because he helped create that income at the S corporation level, but because he was a shareholder of petitioner who was entitled to 99 percent of petitioner's net profit, and Mr. Yeagle was the only investor in the facilities used in connection with petitioner's business operations and in conjunction with all the services and work he performed in petitioner's bvsiness operations. Mr. Yeagle never reported to any other person in petitioner, nor was he ever controlled in any way by petitioner or any other person who could possibly supervise him in his work for petitioner. In other words, Mr. Yeagle had no "employer" in reference to his total and complete control of petitioner and all of petitioner's business operations for each and every year since petitioner's incorporation.

After being notified by IRS of an employment tax audit inquiry, Mr. Yeagle hired the services of a representative who appeared on petitioner's behalf, but neither petitioner, Mr. & Mrs. Yeagle, nor petitioner's representative at the

IRS's initiated employment tax audit of petitioner were ever informed about the provisions of Section 530 of the Revenue Act of 1978, infra, nor were ever given any written notice of the provisions of Section 530 of the Revenue Act of 1978 (Sect. 530) either prior to, at the commencement of or at any time after the audit inquiry by the IRS concerning the question of a proposed employment status of Mr. Yeagle. Neither the Yeagles nor petitioner's representative were ever aware of any of the provisions of Sect. 530 until after the Tax Court delivered its memorandum opinion and decision in this case.

After receiving IRS's Notice of Determination, petitioner then timely filed its petition with the United States Tax Court which was the Court of first instance and which had jurisdiction under 26 U.S.C. Sec. 7436(a), the Federal jurisdictional basis to hear this case in Tax Court.

REASONS RELIED ON FOR ALLOWANCE OF WRIT

I. THERE ARE NUMEROUS CONFLICTING OPINIONS IN DIFFERENT UNITED STATES CIRCUIT COURTS OF APPEAL WITH RESPECT TO THE METHOD USED IN DETERMINING WHETHER AN OFFICER OF A CORPORATION IS AN EMPLOYEE OF THE CORPORATION.

The following is a listing of the conflicts existing between different Circuit Courts, including conflicting opinions within the same Circuit Courts in different cases, concerning the method used in determining whether an officer of a corporation is required to be an employee in an employer-employee relationship under the usual common law rules:

CONFLICT 1: THE THIRD CIRCUIT IN THE PRESENT CASE IS IN CONFLICT WITH THE THIRD CIRCUIT'S DECISION IN Rosenberg v. XM Ventures, 274 F.3d 137,141 (3d Cir. 2001):

The Third Circuit admitted in its own opinion in this case that "by rejecting the taxpayers' [petitioner and VSC] argument, we are avoiding an interpretation of Sec. 3121(d) which would render subparagraph (1) [Sec. 3121(d)(1)] superfluous. See **Rosenberg v. XM Ventures...**" (See App.: p. 7a).

CONFLICT 2: THE THIRD CIRCUIT IN THE PRESENT CASE IS IN CONFLICT WITH THE NINTH CIRCUIT'S DECISION IN Durando v. United States, 70 F.3d 548,552 (9th Cir. 1995):

In 1995 the Ninth Circuit defined how and why an S corporation's income passes through to its shareholder in **Durando**. Even though **Durando** was not an employment tax case, it instructively stated that "[a]n S corporation's income passes through to its shareholders not because they helped to create that income, but because they

are shareholders. See I.R.C. Sect. 1366(a)." The **Durando** Court also stated that Mr. Durando spent "...a substantial amount of time providing business services to at least one of the S corporations..."

In the present case, the Third Circuit relied on **Spicer Accounting, Inc. v. United States**, 918 F.2d 90 (9th Cir. 1990), which suspended the application of the employer-employee relationship tests under the usual common law rules, merely because Mr. Spicer was an "officer" of his S corporation and also its sole shareholder, since no other person besides Mr. Spicer existed in Spicer Accounting, Inc. to qualify as an "employer" under the common law rules of the employer-employee relationship.

It would appear then that the 1995 opinion of the Ninth Circuit in **Durando** supersedes the Ninth Circuit **Spicer** opinion, since the **Spicer** opinion, which would make the Third Circuit's argument in this case, using the flawed interpretation in **Spicer**, a meritless argument, did not apply the employer-employee relationship test to determine whether or not Mr. Spicer was an employee, but concluded he was an employee, merely because he received money from Spicer accountiing, Inc., an S corporation, and, in addition, labeled himself "president" (an "officer") of the S corporation, Spicer Accounting, Inc..

CONFLICT 3: THE NINTH CIRCUIT OPINION IN SPICER, Supra, IS IN CONFLICT WITH THE NINTH CIRCUIT OPINION IN DURANDO, Supra:

For the reasons given in the above two paragraphs under "CONFLICT 2" of this section of the Petition, **Spicer**, supra, is in conflict with **Durando**, supra.

CONFLICT 4: THE NINTH CIRCUIT OPINION IN Spicer, supra, IS IN CONFLICT WITH THE NINTH CIRCUIT OPINION IN Idaho Ambucare Center, Inc. v. U.S., 57 F.3d 752,756 (9th Cir. 1990):

Idaho Ambucare stated:

> "We are not convinced that **Spicer** forecloses the application of a dual capacity analysis. Having concluded that Mr. Spicer performed substantial services, the **Spicer** Court went on to analyze Mr. Spicer's status under the common law rules, implicitly suggesting that if Mr. Spicer were an independent contractor under such rules, he would not be considered a corporate employee, despite his role as a corporate officer performing substantial services. Such approach is entirely consistent with the dual capacity analysis which Ambucare seeks to have us apply."

In other words, the **Spicer** Court ruled that Mr. Spicer was a corporate employee because he had the label of a corporate officer, and that Mr. Spicer did not label himself as an "independent contractor," even though he had all the attributes of an independent contractor as an "officer" and sole shareholder of Spicer Accounting, Inc.. The **Idaho Ambucare** Court, on the other hand, presented the idea of a dual capacity status as a corporate officer as an employee and the same corporate officer as an independent contractor.

CONFLICT 5: THE NINTH CIRCUIT OPINION IN Spicer, supra, IS IN CONFLICT WITH THE NINTH CIRCUIT OPINION IN United States v. Aberdeen Aerie. No. 24 of Fraternal Order of Eagles, 148 F.2d 655 (9th Cir. 1945):

Almost 60 years ago, the Ninth Circuit rejected the "per se" corporate officer being an employee issue in **U.S. v. Aberdeen** which addressed the question as to whether the "president, vice president, treasurer and trustee were 'employees' within the meaning of Title VII of the Social Security Act." The **Aberdeen** Court rejected the argument that an officer is "per se" an employee of the corporation and applied the common law test to find that physicians of the fraternal lodge were officers but were also independent contractors as well, since no one could control their medical work. This was apparently the first case in the Ninth Circuit to recognize dual status in its opinion:

> "...[T]here is considerable discussion by both appellant and appellees with respect to whether Section 1101(a) of Title XI of the Social Security Act, 42 U.S.C.A. 1301(a)(6), applicable to both Titles VIII and IX of that Act, and Sections 1426(d) and 1607(i) of the Internal Revenue Code should be construed to mean that an officer of a corporation is an employee per se. While that question is not properly before this Court, for the District Court made no such finding, we are inclined to agree with the considered weight of authority that each officer must meet the accepted tests of employer-employee relationship to come within the scope of the Act." (148 F.2d at 658).

CONFLICT 6: THE FIRST CIRCUIT OPINIONS IN United States v. Griswold, 124 F.2d 599, 602 (1st Cir. 1941) **AND IN Deecy Products Co. v. Welch**, 124 F.2d 592 (1st Cir. 1941) **ARE IN CONFLICT WITH THE NINTH CIRCUIT OPINION IN Spicer**, supra, AND THE THIRD CIRCUIT IN THIS CASE:

In 1941, the First Circuit rejected the "per se" or ipso facto" argument of a corporate officer being an employee in **United States v. Griswold** which followed its prior case in **Deecy Products Co.**. The legislative history proves that the "officer" language was inserted into 26 U.S.C. 3121(d)(1) to make clear that supervisory persons could obtain social security. **Deecy**, 124 F.2d at 596, noted that the hearings before the Senate Committee on Finance in S.1130, 74 Cong. 1st Sess. 719 (1934) on the Economic Security Act, later to be the Social Security Act of 1935, discussed exceptions of "white collar" workers from the Act.

CONFLICT 7: THE FIFTH CIRCUIT OPINION IN Texas Carbonate Co. v. R.L. Phinney, 307 F.2d 289 (5th Cir. 1962) **IS IN CONFLICT WITH THE OPINIONS IN Spicer**, supra, **Joseph Radtke, S.C. v. United States**, 895 F.2d 1196 (7th Cir. 1990), **AND THE THIRD CIRCUIT OPINION IN THIS CASE:**

In the present case, petitioner relied on the analysis of the Fifth Circuit in **Texas Carbonate Co.** which reasoned that an officer of a corporation was not "per se" an employee of the corporation, but that the common law rules of the employer-employee relationship had to be applied in determining any employment status between an officer and a corporation. The Third Circuit rejected the Fifth Circuit's approach in **Texas Carbonate Co.** and relied solely on the Ninth Circuit in **Spicer** and the Seventh Circuit in **Radtke.**

CONFLICT 8: THE NINTH CIRCUIT OPINION IN Wells v. Clackamas Gastroenterology Associates, P.C., 271 F.3d 903 (9th Cir. 2001), **cert. granted**, No. 01-1435, 123 S.Ct. 31, 153 L.Ed. 2d 893 (Oct. 1, 2002) **IS IN CONFLICT WITH THE NINTH CIRCUIT OPINION**

IN Strother v. Southern California Permanente Medical Group, 79 F.3d 859, 865-68 (9th Cir. 1996) **AND THE SEVENTH CIRCUIT OPINION IN Zimmerman v. N. American Signal Co.,** 704 F.2d 347,351 (7th Cir. 1983):

The issue of labels or titles of reclassified workers versus economic reality as to whether an officer is an employee of the corporation was addressed by **Wells** which had to do with the determination of the employment status of corporate officers holding professional medical licenses. Although it deals with Antidiscrimination Act matters and not a tax case, it construes the definition of employee and will set precedent in tax cases in the same manner as **Nationwide Mutual Ins. Co. v. Darden,** 503 U.S. 318,323-24, 112 S.Ct. 1344, 117 L.Ed. 581 (1992) which was appealed from the Ninth Circuit; wherein the Ninth Circuit in **Nationwide** rejected the "economic realities test" to determine that stockholders were employees.

The dissent in **Wells** argued that under the "economic realities test," the shareholders were not partners, citing **Zimmerman** which held that the terms used to describe the relationship between corporate officers and the corporation are not dispositive of the nature of the relationship. The **Wells** dissent went on to state that the governing factor in determining who is or is not an employee is not determined by "labels" but rather by "realities." (See **EEOC v. Dowd & Dowd, Ltd.,** 736 F.2d 1177 (7th Cir. 1984); **Devine v. Stone, Leyton & Gershman, P.C.,** 100 F.3d 78,80-81 (8th Cir. 1996); **Fountain v. Metcalf, Zima & Co., P.A.,** 925 F.2d 1398, 1400-01 (11th Cir. 1991)). The **Wells** dissent also cited **Strother** and stated that "economic realities are more important than labels." (271 F.3d at 906).

II. THIS CASE INVOLVES AN IMPORTANT QUESTION OF FEDERAL LAW WHICH WAS WRONGLY DECIDED BY THE THIRD CIRCUIT AND WHICH HAS NOT BEEN, BUT SHOULD BE, DECIDED BY THIS COURT.

In this case, the Third Circuit has interpreted 26 U.S.C. Sec. 3121(d)(1) narrowly, exclusively, and out of context in violation of 1 U.S.C. Sec. 1 which states: "In determining the meaning of any act of congress, unless the context indicates otherwise —..." When interpreting the meaning of a statute, it is the obligation of the courts to read a statute in light of its context and apply the generally accepted definition of the words and phrases unsed therein.

The context of Sec. 3121(d)(1) includes other parts of the employment tax statutes in the Internal Revenue Code (Title 26 U.S.C.) along with Section 530 of the Revenue Act of 1978, P.L. 95-600 as amended by P.L. 96-167, P.L. 96-541, P.L. 97-248, P.L. 97-248, P.L. 99-514, and P.L. 104-188 (Sect. 530). Part of the context of the employment tax statutes surrounding Sec. 3121(d)(1), the term employee is defined as a separate person from the employer who is also defined as the "person employing" him or her. The term "employment" in 26 U.S.C. Sec. 3121(b) "means any service, of whatever nature, performed (A) by an employee for the person employing him..." Therefore, an employer must be a different "person" than the "employee." In 26 U.S.C. Sec. 3121(a), "...the term "wages" means all remuneration for employment..." Therefore, where there is no employment between two separate persons, there are no wages due to any individual without the presence of another person who could or actually does employ him. Sec. 3121(c) continually refers to the "person employing him" as the "employer" for purposes of "included and excluded services."

Since it was ruled in **Simbraw v. United States**, 367 F.2d 373 (3d Cir. 1966), that a corporation is not a "person," then by ruling in the present case that John G. Yeagle was petitioner's employee, the Third Circuit is stating here, that the petitioner (S corporation) is the employer identified as "the person employing him" in all the employment tax statutes, and since we know from the context of 26 U.S.C.A. Sec. 3121(d)(1) that an employer must be a person, then the Third Circuit has contradicted itself in this case, pursuant to its **Simbraw** analysis of the nature of a corporation.

The Third Circuit also failed to recognize and apply the plain language definition of "employment status" as contained in Sect. 530(c)(2) (See App.: p. 34a), and nothing in Sec. 3121(d)(1) suspends this definition in determining whether an officer of a corporation is an employee of the corporation. Revenue Procedure 85-18, I.R.B. 1985-13, 27 (App.: p. 35a) allows Sect. 530 to apply to officers of corporations and does not exclude them from safe haven as not being treated as an employee for purposes of Sect. 530. Rev. Proc. 85-18 considers a "reasonable basis" for not treating an individual as an employee to not just being limited to the reasonable bases mentioned in Sect. 530(a), and "that "reasonable basis" should be construed liberally in favor of the taxpayer..."

Petitioner also asks this Court to consider the due process violation commited by Respondent by respondent's failure to comply with the provisions of Sect. 530(e) (App.: p. 26a) by never providing petitioner with the required written notice of the provisions of Sect. 530, and which petitioner asserts was intentional by respondent.

III. THIS CASE HAS BEEN DECIDED BY THE THIRD CIRCUIT IN A WAY THAT CONFLICTS WITH RELEVANT DECISIONS OF THIS COURT.

THE THIRD CIRCUIT OPINION IN THIS CASE IS IN CONFLICT WITH THE SUPREME COURT'S OPINION IN F.Drew Caminetti v. United States, 242 U.S. 470, 37 S.Ct. 192 (1917):

The Third Circuit in this case relied on a non-legislative interpretation of the Internal Revenue Service in its Treasury Regulation 31.3121(d)-1(b) which gives an exception to an officer being treated as an employee based on the amount of work the officer does and not on whether any Sect. 530(c)(2) "employment status" exists between an officer and a corporation. The Treas. Reg. 31.3121(d)-1(b) was published in 26 C.F.R. Sec. 31.3121(d)-1(b). (See App.: p. 5a). This Court ruled in **Caminetti** that "[s]tatutory words are uniformly presumed, unless the contrary appears, to be used in their ordinary and usual sense, and with the meaning commonly attributable to them..." (37 S.Ct. at 194) and further:

> "If the words are plain, they give meaning to the act, and it is neither the duty nor the privilege of the courts to enter speculative fields in search of a different meaning...when the words are free from doubt, they must be taken as the final expression of the legislative intent, and are not to be added to or subtracted from by consideration drawn from titles or designating names...or from any extraneous source. In other words, the language being plain, and not leading to absurd or wholly impractical consequences, it is the sole evidence of the ultimate legislative intent." (37 S.Ct. at 196).

THE THIRD CIRCUIT OPINION IN THIS CASE IS IN CONFLICT WITH THE SUPREME COURT'S OPINION IN Rowland v. California Men's Colony, Unit II Men's Advisory Counsel, 506 U.S. 194, 113 S.Ct. 716 (1993):

By declaring that Petitioner was the employer of Mr. Yeagle, the Third Circuit identified Petitioner as a "person," since only a person can be an employer of another person. Since **Rowland** ruled that a corporation is not a person, and that it is, instead, an "artificial entity" that cannot give authority to its officer or control its officer, then it cannot be an employer of its officer as well. This is true, because all the employment tax statutes define an employer as a person. (See Secs. 3121(a), 3121(b), 3121(c) and 3121(d) and Sect. 530).

THE THIRD CIRCUIT OPINION IN THIS CASE IS IN CONFLICT WITH THE SUPREME COURT'S OPINION IN David A. Gitlitz, et ux, et al v. Commissioner of Internal Revenue, 121 S.Ct. 701 (2001):

Gitlitz addressed the narrow, exclusive, and out of context reading of 26 U.S.C. Sec. 108(d)(7)(A) with reference to how cancellation of debt should be passed through from an S corporation to its shareholder:

> "The very purpose of a subchapter S is to tax at the shareholder level...[N]othing in Sect. 108(d)(7)(A) suspends the operation of these ordinary pass through rules...The Commissioner finds support for his literal exclusive reading of Sect. 108(d)(7)(A)'s language in the fact his reading would close a significant tax loophole."

Just as the pass through rules, contained in 26 U.S.C. Sec. 1366, of an S corp. to its

shareholder are not suspended by Sec. 108(d)(7)(A), according to **Gitlitz**, those same pass through rules, pertaining to the instructions as to the character of income passed through by an S corp. to its shareholder (Sec. 1366(b)), are not suspended by Sec. 3121(d)(1), just because the shareholder chooses to label himself an "officer" title. In other words, according to Sec. 1366(b), the character of income coming to the S corp. is the same as that passing through to its shareholder. If income earned by the S corp. was not characterized as "wages" from an employer to an employee, then that income passed through to the shareholder cannot be characterized as "wages" either.

In the instant case, the I.R.S. perceived that the treatment of Mr. Yeagle as not being an employee would be a tax loophole needing to be closed by declaring him an employee of petitioner, so that FICA and FUTA employment taxes could be assessed against petitioner. Self employment social security taxes are not assessable on the income passed through from an S corp. to its shareholder, pursuant to I.R.S. Revenue Ruling 1959-1 C.B. 225 which addressed the question as to whether an S corp. shareholder was really self employed and, as such, subject to the same rate of social security tax assessed against employers and employees.

IV. THE I.R.S. MISLEAD PETITIONER IN TWO WAYS:

1. The I.R.S. waited nine years after petitioner incorporated to reclassify Mr. Yeagle as an employee of petitioner. Petitioner was formed in 1989, and it was not until 1998 that I.R.S. told petitioner that its shareholder was an employee of petitioner; thereby assessing a greater liability against petitioner than the smaller liability for only 1989.

2. Petitioner asserts that I.R.S. did not comply with the requirement of Sect. 530(e) (App.: p. 26a) by never providing petitioner with the written notice of the provisions of Sect. 530, so that petitioner would not have had the benefit of access to the "safe havens" from I.R.S.'s determination that Mr. Yeagle was an employee of petitioner, since he was never an employee of petitioner under the definition of "employment status" contained in Sect. 530(c)(2) as applied to petitioner and Mr. Yeagle, the only living **"person"** in petitioner during the years at issue in this case.

CONCLUSION

THEREFORE, petitioner, YEAGLE DRYWALL COMPANY, INC., requests this Court that it GRANT ITS Petition for a Writ of Certiorari to the United States Court of Appeals for the Third Circuit.

RESPECTFULLY SUBMITTED,

Joseph H. O'Donnell, Jr.,
Counsel of Record

116 East Allen Street
Philadelphia, PA 19125
(215) 426-3245

Attorney for petitioner

(2)

Supreme Court, U.S.
FILED

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OFFICE OF THE CLERK

No.

In the

Supreme Court of the United States

YEAGLE DRYWALL COMPANY, INC.,

Petitioner

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

PETITION FOR A WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE THIRD CIRCUIT

APPENDIX

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30pp

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CORPORATE DISCLOSURE STATEMENT

The Petitioner: YEAGLE DRYWALL COMPANY, INC.
(a corporation, incorporated in Pennsylvania)

YEAGLE DRYWALL COMPANY, INC., the petitioner, is a nongovernmental corporate party to the proceedings and was a party to the proceedings as the "Petitioner" in the United States Tax Court and the "Appellant" in the United States Court of Appeals for the Third Circuit.

YEAGLE DRYWALL COMPANY, INC.does not now have nor has ever had any parent or subsidiary corporations, and it is not now nor has ever been the parent corporation of another corporation nor has it ever been a subsidiary corporation of anothe corporation.

No publicly held corporation nor any other corporation owns or ever has owned 10 percent or more of the stock of YEAGLE DRYWALL COMPANY, INC..

NOT PRECEDENTIAL

UNITED STATES COURT OF APPEALS
FOR THE THIRD CIRCUIT

Case Nos. 02-1132 and 02-1214

YEAGLE DRYWALL COMPANY, INC.,
Appellant in No. 02-1132

v.

COMMISSIONER OF INTERNAL REVENUE

VETERINARY SURGICAL CONSULTANTS, P.C.,
Appellant in No. 02-1214

v.

COMMISSIONER OF INTERNAL REVENUE

On Appeal from the United States Tax Court
(Nos. 00-3908 and 99-2500)
Tax Judge: The Honorable Julian I. Jacobs

Submitted under Third Circuit LAR 34.1
December 3, 2002

Before: ROTH, SMITH and CUDAHY,* Circuit Judges

(Filed: December 18, 2002)

*Honorable Richard Cudahy, Circuit Judge for the United States Court of Appeals for the Seventh Circuit, sitting by designation.

OPINION

D. BROOKS, Circuit Judge:

This consolidated appeal challenges determinations by the United States Tax Court that an officer and shareholder of each of the corporate taxpayers was an employee and that the taxpayer was therefore liable for taxes under the Federal Insurance Contributions Act ("FICA"), 26 U.S.C. Secs. 3101-3128, and the Federal Unemployment Tax Act ("FUTA"), 26 U.S.C. Secs. 3301-3311. For the reasons set forth below, we will affirm.

I.

The taxpayers, Veterinary Surgical Consultants, P.C. ("VSC") and Yeagle Drywall Company, Inc. ("YDC"), both received from the Internal Revenue Service ("IRS") a "Notice of Determination Concerning Worker Classification Under Section 7436." VSC's notice, dated November 17, 1998, advised that the IRS had determined that Kenneth K. Sadanaga, D.V.M., was to be classified as an employee for purposes of federal employment taxes for all quarters in 1994, 1995 and 1996 and that the taxpayer was not "entitled to relief from this classification pursuant to section 530 of the Revenue Act of 1978." VSC filed a timely petition for redetermination with the United States Tax Court and the parties stipulated to the facts. The stipulation established that the taxpayer was a subchapter "S" corporation which provided consulting and surgical services to vaterinarians. The corporation was solely owned by Dr. Sadanga, who was also its president and its only officer since incorporation. He alone performed the veterinary services rendered by VSC. In addition to his

professional services, Dr. Sadanga managed the business, performing all the administrative tasks.

VSC did not make regular payments to Dr. Sadanga for his services. Instead the money from VSC's bank account was withdrawn by Dr. Sadanga as the need arose. The payments were not listed by VSC on its federal Form 1120S return as compensation to its officer or as wages. Instead, VSC computed its ordinary income and Dr. Sadanga indicated this amount as non-passive income on the Schedule K-1 of his Form 1040 Return. The non-passive income on his returns for 1994, 1995, and 1996, respectively, was $83,995.50, $173,030.39, and $161,483.35.

The IRS issued its Notice of Determination Concerning Worker Classification to YDC in February, 2000, advising that John Yeagle was classified as an employee for calendar years 1995, 1996, and 1997. Yeagle owned 99% of the business, with the remaining 1% in his wife's name. Yeagle was president of his business since its incorporation and performed the following services: soliciting business; ordering supplies; executing agreements; managing finances; and hiring and firing independent contractors.

Yeagle, like Sadanaga, did not receive payments from his company on a regular basis. Rather, Yeagle "would take money from [YDC's] bank account as Mr. Yeagle's needs arose and/or would pay personal expenses from such account as he desired." Like VSC, Yeagle Drywall did not pay employment taxes for the services rendered by its owner, John Yeagle. Instead, it filed a Form 1120S reflecting the income earned by the corporation and Yeagle indicated that amount as non-passive income on the Schedule K-1 of his Form 1040 Return. The non-passive income reported for 1995, 1996, and 1997, respectively, was $26,711.08, $32,973.39, and $34,508.90.

Based on these stipulated facts, the Tax Court determined, in separate decisions, that the IRS had not erred in classifying Dr. Sadanga and John Yeagle as employees under the FICA and the FUTA. It found that the payments received by Dr. Sadanga and Yeagle were remuneration for the substantial services performed on behalf of the corporate taxpayer and that VSC and YDC were liable for the unpaid FICA and FUTA taxes. The Tax Court also concluded that neither taxpayer could obtain relief from the taxes due under the safe harbor established by section 530 of the Revenue Act of 1978.

II.

We have "exclusive jurisdiction" under 26 U.S.C. Sec. 7482(a)(1) "to review the decisions of the Tax Court. . .in the same manner and to the same extent as decisions of the district courts in civil actions tried without a jury[.]" 26 U.S.C. Sec. 7482(a)(1). "Thus, we have plenary review over the Tax Court's findings of law, including its construction and application of the Internal Revenue Code." **PNC Bancorp, Inc. v. Commissioner of Internal Revenue**, 212 F.3d 822, 827 (3d Cir. 2000).

III.

FICA and FUTA impose taxes on employers based on the wages paid to individuals in their employ. 26 U.S.C. Secs. 3111, 3301. "Wages" is defined broadly by both Acts, with certain exceptions not applicable here, as "all remuneration for employment[.]" 26 U.S.C. Secs. 3121(a), 3306(b). Employment is defined as "any service of whatever nature, performed.. .by an employee for the person employing him[.]" 26 U.S.C. Secs. 3121(b), 3306(c). FICA also defines "employee," in pertinent part, as:

> (1) any officer of a corporation; or
> (2) any individual who, under the usual common law rules applicable in determining the employer-employee relationship, has the status of an employee[.] 26 U.S.C. Sec. 3121(d).

Treasury regulation Sec. 31.3121(d)-1(b) restates the general rule that an officer of a corporation is an employee of the corporation and specifies that there is an exception for an "officer of a corporation who as such does not perform any services or performs only minor services and who neither receives nor is entitled to receive, directly or indirectly, any remuneration[.]" 26 C.F.R. Sec. 31.3121(d)-1(b).

Consistent with this law, the Tax Court focused on whether the distributions of income made by VSC and YDC were remuneration for the services performed by Dr. Sadanga and John Yeagle. The court found that each of these individuals performed substantial services for the corporate taxpayers and that the distributions of income received were, in fact, remuneration for the services rendered. Accordingly, it held that the taxpayers were liable for federal employment taxes under the FICA and the FUTA.

We agree. Under the FICA, an officer of a corporation is an employee unless he performs only minor services. 26 U.S.C. Sec. 3121(d)(1); 26 C.F.R. Sec. 31.3121(d)-1(b). Dr. Sadanga's services were anything but minor inasmuch as he was the only source of revenue for VSC and performed all of the administrative tasks. Likewise, John Yeagle managed and directed all of the activities undertaken by YDC. Because these services were substantial, the Tax Court did not err in concluding that the distributions of income paid by the corporate taxpayers were remuneration for services rendered, thereby

constituting wages under the FICA and the FUTA.

The Ninth Circuit's decision in **Spicer Accounting, Inc. v. United States**, 918 F.2d 90 (9th Cir. 1990), is instructive. There, the court determined that the dividends paid by an S corporation to a shareholder, who was also an officer and the only certified public accountant performing services for the business, were wages. It relied upon: (1) treasury regulations which provide that the "form of payment is immaterial, the only relevant factor being whether the payments were actually received as compensation for employment," id. (citing 26 C.F.R. Secs. 31.3121(a)-1(b), 31.3306(b)-1(b)); (2) the definition of employee in Sec. 3121(d)(1); and (3) the exception contained in the treasury regulation for officers performing minor services, 26 C.F.R. Sec. 31.3121(d)-1(b). Because Mr. Spicer was the only individual providing accounting services to the corporation and these services were substantial, the court concluded that the dividends were remuneration and subject to federal employment taxes. 918 F.2d at 92-93; see also **Joseph Radtke, S.C. v. United States**, 895 F.2d 1196 (7th Cir. 1990).

The taxpayers argue, however, that the Tax Court erred because it failed to consider whether, under the stipulated facts, Dr. Sadanga and John Yeagle were employees "under the usual common law rules applicable in determining the employer-employee relationship," as provided by Sec. 3121(d)(2). They rely upon **Texas Carbonate Co. v. Phinney**, 307 F.2d 289 (5th Cir. 1962), which conducted an employer-employee analysis, consistent with Sec. 3121(d)(2), despite the fact that the purported employee was an officer of the corporate taxpayer.

Reliance upon **Texas Carbonate** is misplaced for two reasons. First, it is neither binding nor

authoritative in light of its failure to apply the plain language of Sec. 3121(d) which defines employee by using the conjunction "or" between subparagraphs (1) and (2). This conjunction signifies an intent that an individual may qualify as an employee under either set of circumstances. Here, Dr. Sadanga and John Yeagle satisfy the criteria set forth in Sec. 3121(d)(1) and the applicable treasury regulation Sec. 31.3121(d)-1(b), thereby obviating any reason to analyze whether they are employees under the usual common law rules under subparagraph (2). It is important to point out that by rejecting the taxpayers' argument, we are avoiding an interpretation of Sec. 3121(d) which would render subparagraph (1) superfluous. See **Rosenberg v. XM Ventures**, 274 F.3d 137, 141 (3d Cir. 2001).

Second, despite the **Texas Carbonate** court's failure to recognize the applicability of Sec. 3121(d)(1), its analysis considered whether the services of the officer, in the absence of any control by the corporation, were substantial. It pointed out that the officer was a stockholder, a director, and a manager of the company, in charge of its sales, and the development of its markets. These services, in the court's view, were substantial and justified the determination that: (1) the officer was an employee; and (2) the corporation was liable for federal employment taxes. 307 F.2d at 292-93.

IV.

Under Section 530 of the Revenue Act of 1978, there is a safe harbor for taxpayers who owe FICA and FUTA taxes as a result of wrongfully failing to classify certain individuals as employees. See P.L. 95-600, as amended by P.L. 96-167, P.L. 96-541, P.L. 97-248, P.L. 99-514 and P.L. 104-188 (hereinafter cited as "Section 530"). This uncodified section relieves a taxpayer of certain federal employment

tax liabilities arising from a failure to treat an individual as an employee if the taxpayer had a "reasonable basis for not treating such individual as an employee." Section 530 (a)(1): **303 West 42nd St. Enter., Inc. v. I.R.S.**, 181 F.3d 272, 274 (2d Cir. 1999). Section 530(a)(2) specifies thst a taxpayer shall be treated as having a reasonable basis for not treating an individual as an employee if it reasonably relied on:

> (A) judicial precedent, published rulings, technical advice with respect to the taxpayer, or a letter ruling to the taxpayer;
> (B) a past Internal Revenue Service audit of the taxpayer[;] or
> (C) long standing recognized practice of a significant segment of the industry in which such individual was engaged.

Section 530 (a)(2)

Here, the taxpayers assert that the Tax Court improperly determined that they were not entitled to relief under this safe harbor provision. They contend that there was a reasonable basis for not treating Dr. Sadanga and John Yeagle as employees, citing the judicial precedent in **Texas Carbonate**, 307 F.2d at 289.

As we explained above, **Texas Carbonate** is not authoritative and it does not support the taxpayers' argument that Dr. Sadanga and John Yeagle were not employees. Thus, any reliance upon **Texas Carbonate** by either VSC or YDC was unreasonable, particularly in light of the subsequent decisions in **Radtke**, 895 F.2d at 1197-98, and **Spicer Accounting**, 918 F.2d at 94-95. Indeed, **Spicer Accounting** rejected the taxpayer's argument that it had a reasonable basis for not treating its officer as an employee under Section 530 and should not be held liable. The court reasoned that Mr. Spicer was "for all

practical purposes, the central worker for the taxpayer" and it declared that a "corporation's sole full-time worker must be treated as an employee." 918 F.2d at 95.

Finally, the taxpayers argue that their due process rights were violated because the IRS failed to give written notice of the provisions of Section 530 at either audits. This argument was not raised before the Tax Court and we will not consider it for the first time on appeal. **Harris v. City of Philadelphia**, 35 F.3d 840, 845 (3d Cir. 1994).

V.

Accordingly, because Dr. Sadanga and John Yeagle were properly classified by the IRS as employees of VSC and YDC, respecively, and there was no reasonable basis for not treating them as employees, we will affirm the decision of the Tax Court.

To the Clerk of Court:

Please file the foregoing Opinion.

"s/ D. Brooks Smith "

Circuit Judge

UNITED STATES COURT OF APPEALS
FOR THE THIRD CIRCUIT

Case Nos: 02-1132 and 02-1214

YEAGLE DRYWALL COMPANY, INC.,
Appellant in No. 02-1132

V.

COMMISSIONER OF INTERNAL REVENUE

VETERINARY SURGICAL CONSULTANTS, P.C.,
Appellant in No. 02-1214

V.

COMMISSIONER OF INTERNAL REVENUE

On Appeal from the United States Tax Court
(Nos. 00-3908 and 99-2500)
Tax Judge: The Honorable Julian I. Jacobs

Submitted under Third Circuit LAR 34.1
December 3, 2002

Before: ROTH, SMITH and CUDAHY*, Circuit Judges

*Honorable Richard Cudahy, Circuit Judge for the United States Court of Appeals for the Seventh Circuit, sitting by designation.

JUDGMENT

These cases came to be heard from the United States Tax Court and were submitted on December 3, 2002. On consideration whereof, it is now here ORDERED AND ADJUDGED by this court that the Memorandum Opinions and Orders entered by the United States Tax Court on October 15, 2001, be and the same are hereby AFFIRMED.

ATTEST:

"s/Kathleen Brouwer"
Acting Clerk

Dated: December 18, 2002

Certified as a true copy and issued in lieu of a formal mandate on 3/13/03

Teste: "s/Kathleen Brouwer "

Chief Deputy Clerk, U.S. Court of Appeals for the Third Circuit.

T.C. Memo. 2001-284

UNITED STATES TAX COURT

YEAGLE DRYWALL COMPANY, INC.,
Petitioner v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent

Docket No. 3908-00 Filed October 15, 2001.

Joseph H. O'Donnell, Jr., for petitioner.

Linda P. Azmon, for respondent.

MEMORANDUM OPINION

JACOBS, Judge: This case is before the Court on a petition for redetermination of a Notice of Determonation Concerning Worker Classification Under Section 7436 (Notice of Determination). It was submitted to the Court fully stipulated under Rule 122. The sole issue to be decided is whether John G. Yeagle (Mr. Yeagle) is an employee of petitioner for the period at issue (each of the four quarters of 1995, 1996, and 1997) for purposes of Federal employment taxes. For convenience, we use the term "Federal employment tax" to refer to taxes under secs. 3101-3125 (enacted as Federal Insurance Contributions Act (FICA), ch. 9, 53 Stat. 175 (1939)) and secs. 3301-3311 (enacted as Federal Unemployment Tax Act (FUTA), ch. 9, 53 Stat. 183 (1939)).

Rule references are to the Tax Court Rules of Practice and Procedure, and except as otherwise noted, section references are to the Internal Revenue Code in effect for the years at issue.

Background

The stipulation of facts and the attached exhibits are incorporated herein. The stipulated

facts are hereby found.

Petitioner is an S corporation that was incorporated in Pennsylvania on October 2, 1989. At the time the petition was filed , petitioner's principal place of business was in Quakertown, Pennsylvania. Petitioner operates a drywall construction business that is the sole source of petitioner's income. Mr. Yeagle owns 99 percent of petitioner's stock. Mr. Yeagle's wife, Terree Yeagle (Mrs. Yeagle), owns the remaining 1 percent. Since petitioner's incorporation, Mr. Yeagle has been its president, and Mrs. Yeagle has been its vice president and secretary.

Mr. Yeagle performs many services for petitioner, including soliciting business, ordering supplies, entering into oral and written agreements, overseeing finances, collecting money owed to petitioner, hiring and firing independent contractors, obtaining clients, maintaining client relationships, and generally managing petitioner's business affairs.

During the period at issue, all payments made to petitioner were deposited into petitioner's checking account. Mr. Yeagle is the only person with signature authority on petitioner's bank account. Petitioner did not make regular payments to Mr. Yeagle; Mr. Yeagle withdrew money from petitioner's bank account at his discretion. Mr. Yeagle also paid personal expenses from petitioner's bank account at his discretion. Mr. Yeagle did not receive any wages, salary, or tips from any other business entity, or income from any other S corporation during 1995, 1996, and 1997.

During the period at issue, petitioner did not treat any individual, including Mr. Yeagle, as an employee, and did not file a form 941, Employer's Quarterly Federal Tax Return, or a Form 940, Employer's Annual Federal Unemployment Tax Return, for any quarter during the period at issue. Petitioner treated individuals who

performed services for it, other than Mr. Yeagle, as independent contractors and issued Forms 1099-MISC, Miscellaneous Income, to those individuals. Petitioner did not issue a Form 1099-MISC or a Form W-2, Wage and Tax Statement, to Mr. Yeagle for 1995, 1996, or 1997.

On Forms 1120S, U.S. Income Tax Return for an S Corporation, petitioner reported net income from its trade or business for 1995, 1996, and 1997, in the respective amounts of $26,711.08, $32,973.39, and $34,508.90. Petitioner paid these amounts to Mr. Yeagle and reported these amounts as the Yeagles' share of its income on Schedules K-1, Shareholders' Shares of Income, Credits, Deductions, etc., of the Forms 1120S. Petitioner did not allocate the income between Mr. and Mrs. Yeagle.

During 1995, 1996, and 1997, petitioner distributed all of its net income to the Yeagles. Petitioner reported on Schedules M-2, Analysis of Accumulated Adjustments Account, Other Adjustments Account, and Shareholders' Undistributed Taxable Income Previously Taxed, of the Forms 1120S that the amounts it paid to the Yeagles were distributions other than dividend distributions paid from accumulated earnings and profits.

The Yeagles timely filed Forms 1040, U.S. Individual Income Tax Returns for 1995, 1996, and 1997. On Schedule E, Supplemental Income and Loss, of the Yeagles' Forms 1040s, they reported their share of petitioner's income (as indicated on Schedules K-1) as nonpassive income from an S corporation.

On February 23, 2000, respondent issued to petitioner a Notice of Determination, in which respondent determined that (1) Mr. Yeagle was petitioner's employee for purposes of Federal employment taxes, and (2) petitioner was not entitled to 'safe harbor" relief from these taxes

as provided by section 530 of the Revenue Act of 1978, Pub. L. 95-600, 92 Stat. 2885 (Section 530). Attached to the Notice of Determination was a schedule detailing the amount of the proposed Federal employment taxes. Thereafter, petitioner filed with the Court a timely petition seeking our review of respondent's Notice of Determination.

Discussion

Petitioner contends that Mr. Yeagle was not its employee and that it properly distributed its net income to the Yeagles, as its only shareholders, pursuant to section 1366. On the other hand, respondent contends that Mr. Yeagle was an employee of petitioner because he was an officer of petitioner and performed substantial services on petitioner's behalf.

Sections 3111 and 3301 impose FICA (social security) and FUTA (unemployment) taxes on employers for wages paid to their employees. An officer of a corporation, "who performs substantial services for a corporation and who receives remuneration in any form for those services is considered an employee, whose wages are subject to Federal employment taxes." **Veterinary Surgical Consultants, P.C. v. Commissioner**, 117 T.C. --, -- (2001)(slip op. at 7); see also sec. 3121(d); sec. 31.3121(d)-1(b), Employment Tax Regs.

With respect to the case at hand, Mr. Yeagle is an officer of petitioner who performed substantial services for petitioner, including soliciting business, ordering supplies, entering into oral and written agreements, overseeing finances, collecting money owed to petitioner, hiring and firing independent contractors, obtaining clients, maintaining client relationships, and generally managing petitioner's business affairs.

Petitioner distributed all of its net income to the Yeagles. Those distributions were compensation for the services provided to petitioner by Mr. Yeagle.

Petitioner contends that the amounts paid to Mr. Yeagle were distributions of its corporate net income, rather than wages, and that Mr. Yeagle properly reported the net income as nonpassive income from an S corporation on his Forms 1040s. Mr. Yeagle's reporting the distributions as nonpassive income from an S corporation has no bearing on the Federal employment tax treatment of those wages. **Veterinary Surgical Consultants, P.C. v. Commissioner**, supra at -- (slip op. at 8). We hold that Mr. Yeagle is an employee of petitioner for the period at issue and, as such, the payments to him from petitioner constitute wages subject to Federal employment taxes.

Despite our determination that Mr. Yeagle is an employee of petitioner and that the payments to him from petitioner are wages subject to Federal employment taxes, Section 530 allows petitioner relief from employment tax liability if two conditions are satisfied. Section 530(a)(1) provides in relevant part:

> (1) In general.-- If
>
> > (A) for purposes of employment taxes, the taxpayer did not treat an individual as an employee for any period * * *, and
> >
> > (B) in the case of periods after December 31, 1978, all Federal tax returns (including information returns) required to be filed by the taxpayer with respect to such individual for such period are filed on a basis consistent with the taxpayer's treatment of such

individual as not being an employee,

then, for purposes of applying such taxes for such period with respect to the taxpayer, the individual shall be deemed not to be an employee unless the taxpayer had no reasonable basis for not treating such individual as an employee."

Here, the first of the two conditions is satisfied. Petitioner did not treat Mr. Yeagle as an employee during the period in issue. Since its incorporation, petitioner filed its tax returns reflecting all withdrawals by Mr. Yeagle as distributions of petitioner's net income, not wages.

However, the second condition of Section 530(a)(1) is not satisfied because petitioner had no reasonable basis for not treating Mr. Yeagle as an employee. For purposes of Section 530(a)(1), a taxpayer is treated as having a reasonable basis for not treating an individual as an employee if the taxpayer's treatment of the individual was in reasonable reliance of judicial precedent, published rulings, technical advice with respect to the taxpayer, a letter ruling to the taxpayer, or longstanding recognized practice of a significant segment of the industry in which the individual was engaged. Section 530(a)(2); see also **Veterinary Surgical Consultants, P.C. v. Commissioner**, supra, at -- (slip op. at 10-11); Rev. Proc. 85-18, 1985-1 C.B. 518.

Petitioner cites to the identical cases and ruling addressed in **Veterinary Surgical Consultants, P.C. v. Commissioner**, supra, and makes the same arguments as those made by the taxpayer in that case. For the reasons set forth in that opinion, we find that petitioner did not have a reasonable basis for not treating Mr. Yeagle as an employee.

In this case, respondent's position is supported by the plain language of the statute, the applicable Treasury regilations, published revenue rulings, and cases interpreting the applicable statutes. Petitioner's position is inconsistent with the weight of authority.

We have considered all of petitioner's arguments, and, to the extent not specifically addressed, we find them unpersuasive or irrelevant.

After the petition was filed in this case, Congress amended section 7436(a) to provide this Court with jurisdiction to determine the correct amounts of Federal employment taxes that relate to the Secretary's determination concerning worker classification. See Community Renewal Tax Relief Act of 2000 (CRTA), Pub. L. 106-554, sec. 314(f), 114 Stat. 2763A-643. That amendment was made retroactive to the effective date of section 7436(a). CRTRA sec. 314(g), 114 Stat. 2763A-643.

The parties filed a Stipulation of Settled Issues setting forth the proper amount of Federal employment taxes owed by petitioner in the event we find that Mr. Yeagle is petitioner's employee for purposes of Federal employment taxes (which we do). The amount so stipulated will be reflected in our decision document.

To reflect the foregoing,

Decision will be entered for respondent in accordance with the parties' stipulations as to amounts.

UNITED STATES TAX COURT
WASHINGTON, D.C. 20217

YEAGLE DRYWALL COMPANY, INC.	*	
Petitioner,	*	
V.	*	Docket No. 3908-00
COMMISSIONER OF INTERNAL REVENUE	*	**EMPLOYMENT**
Respondent.	*	

DECISION

Pursuant to the determination of the Court as set forth in its Memorandum Findings of Fact and Opinion, filed October 15, 2001, it is

ORDERED and DECREED that with respect to the Notice of Determination Concerning Worker Classification Under Section 7436, dated February 7, 2000, John G. Yeagle was an employee of petitioner for purposes of Federal employment taxes for the taxable periods 1995, 1996, and 1997.

That petitioner is not entitled to relief under section 530 of the Revenue Act of 1978.

That the amounts of Federal Insurance Contribution Act (FICA) tax imposed under I.R.C. sections 3101 and 3102(a) due from petitioner for the taxable periods 1995, 1996, and 1997 are as follows:

Tax Period Ended	Amount of Tax
March 31, 1995	$1,021.69
June 30, 1995	1,021.69
September 30, 1995	1,021.69
December 31, 1995	1,021.69
March 31, 1996	$1,261.21
June 30, 1996	1,261.21
September 30, 1996	1,261.21
December 31, 1996	1,261.21
March 31, 1997	$1,319.97
June 30, 1997	1,319.97
September 30, 1997	1,319.97
December 31, 1997	1,319.97

That the amounts of Federal Unemployment Act Tax (FUTA) tax imposed under I.R.C. section 3301(a) due from petitioner for the taxable periods 1995, 1996, and 1997 are as follows:

Tax Period Ended	Amount of Tax
December 31, 1995	$434.00
December 31, 1996	434.00
December 31, 1997	434.00

"S/Julian I. Jacobs"

Julian I. Jacobs
Judge

ENTERED: OCT 16 2001

UNITED STATES COURT OF APPEALS
FOR THE THIRD CIRCUIT

Case Nos: 02-1132 and 02-1214

YEAGLE DRYWALL COMPANY, INC.,
Appellant in No. 02-1132

AND

VETERINARY SURGICAL CONSULTANTS, P.C.,
Appellant in No. 02-1214

v.

COMMISSIONER OF INTERNAL REVENUE

United States Tax Court Nos.:
00-3908 and 99-2500

SUR PETITION FOR REHEARING

Present: BECKER, Chief Judge,

SLOVITER, SCIRICA, NYGAARD, ALITO, ROTH,
McKEE, RENDELL, BARRY, AMBRO, FUENTES,
SMITH and CUDAHY*, Circuit Judges

The petition for rehearing filed by appellants in the above-entitled cases having been submitted to the judges who participated in the decision of this Court and to all the other available circuit judges of the circuit in regular active service, and no judge who concurred in the decision having asked for rehearing, and a majority of the circuit judges of the circuit in regular service not having voted for rehearing, the petition for rehearing by the panel and the Court en banc, is denied.

BY THE COURT,

"s/D. BROOKS SMITH "

Circuit Judge

Dated: MARCH 05, 2003

*The Honorable Richard D. Cudahy, United States Court of Appeals for the Seventh Circuit, who sat on the original panel, is limited to panel rehearing only.

PERTINENT PORTIONS OF THE TEXT OF FEDERALLY ENACTED STATUTES RELEVANT TO THIS CASE PURSUANT TO SUPREME COURT RULES: 14.1.(f) and 14.1.(i)(v)

The following represents the pertinent parts of various Statutes which are being relied on by the Petitioner and referred to in the body of the Petition. In addition to the following Statutes, Petitioner is hereby including pertinent portions of relevant Internal Revenue Service pronouncement (Rev. Proc. 85-18):

I. PERTINENT PARTS OF FEDERALLY ENACTED STATUTES:

A. 26 U.S.C. Sec. 1366:

"SEC. 1366 PASS-THRU OF ITEMS TO SHAREHOLDERS.

(a). DETERMINATION OF SHAREHOLDER'S TAX LIABILITY.—

(1) IN GENERAL.—In determining the tax under this chapter of a shareholder for the shareholder's taxable year in which the taxable year of the S corporation ends... there shall be taken into account the shareholder's pro rata share of the corporation's—

(A) items of income. . .loss, deduction, or credit the separate treatment of which could effect the liability for tax of any shareholder, and

(B) nonseparately computed income or loss...

(b) CHARACTER PASSED THRU.—The character of any item included in a shareholder's pro rata share under paragraph (1) of subsection (a) shall be determined as if such item were realized directly from the source from which realized by the

corporation, or incurred in the same manner as incurred by the corporation.
(c) GROSS INCOME OF A SHAREHOLDER.—In any case where it is necessary to determine the gross income of a shareholder for purposes of this title, such gross income shall include the shareholder's pro rata share of the gross income of the corporation.

B. 26 U.S.C. Sec. 3121(d):

"(d) EMPLOYEE.—For purposes of this chapter, the term "employee" means—

(1) any officer of a corporation; or

(2) any individual who, under the usual common law rules applicable in determining the employer-employee relationship, has the status of an employee; or

(3) any individual (other than an individual who is an employee under paragraph (1) or (2) who performs services for remuneration for any person —. . .

If the contract of service contemplates that substantially all of such services are to be performed personally by such individual; except that an individual shall not be included in the term "employee" under the provisions of this paragraph if such individual has a substantial investment in facilities used in connection with the performance of such services (other than in facilities for transportation), or if the services are in the nature of a single transaction not part of a continuing relationship with the person for whom the services are performed. . ."

C. Relevant excerpts from Section 530 of the Revenue Act of 1978 (a/k/a: "The Small Business Protection Act of 1978), P.L. 95-600 as amended by P.L. 96-167, P.L. 96-541, P.L. 97-248, P.L. 99-514, and P.L. 104-188:

"Act Sec. 530(a) TERMINATION OF CERTAIN EMPLOYMENT TAX LIABILITY.—
(1) IN GENERAL.—If—

(A) for purposes of employment taxes, the taxpayer did not treat an individual as an employee for any period, and

(B) In the case of periods after December 31, 1978, all Federal tax returns (including information returns) required to be filed by the taxpayer with respect to such individual for such period are filed on a basis consistent with the taxpayer's treatment of such individual as not being an employee, then for purposes of applying such taxes for such period with respect to the taxpayer, the individual shall be deemed not to be an employee unless the taxpayer had no reasonable basis for not treating such individual as an employee.

(2) STATUTORY STANDARDS PROVIDING ONE METHOD OF SATISFYING THE REQUIREMENTS OF PARAGRAPH (1).—For purposes of paragraph (1), a taxpayer shall in any case be treated as having a reasonable basis for not treating an individual as an employee for a period if the taxpayer's treatment of such individual for such period was in reasonable reliance on any of the following:

(A) judicial precedent, published rulings, technical advice with respect to the taxpayer, or a letter ruling to the taxpayer;

(B) a past Internal Revenue Service audit of the taxpayer in which there was no assessment attributable to the treatment (for employment tax purposes) of the individuals holding positions substantially similar to the position held by this individual; or

(C) long-standing recognized practice of a significant segment of the industry in which such individual was engaged. . ."

"Act Sec. 530(b) PROHIBITION AGAINST REGULATIONS AND RULINGS OF EMPLOYMENT STATUS.—No regulation or Revenue Ruling shall be published on or after the date of the enactment of this Act and before the effective date of any law hereafter enacted clarifying the employment status of individuals for purposes of the employment taxes by the Department of the Treasury (including the Internal Revenue Service) with respect to the emplyment status of any individual for purposes of the emplyment taxes."

"Act Sec. 530(c) DEFINITIONS.—For purposes of this section—

(1) EMPLOYMENT TAX.— The term "employment tax" means any tax imposed by Subtitle C of the Internal Revenue Code of 1954.

(2) EMPLOYMENT STATUS.— The term "employment status" means the status of an individual, under the usual common law rules applicable in determining the employer-employee relationship, as an employee or as an independent contractor (or other individual who is not an employee)."

"Act Sec. 530(e) SPECIAL RULES FOR APPLICATION OF SECTION.—

(1) NOTICE OF AVAILABILITY OF SECTION.— An officer or employee of the Internal Revenue Service shall, before or at the commencement of any audit inquiry relating to the employment status of one or more individuals who perform services for the taxpayer, provide the taxpayer with a written notice of the provisions of this section."

II. PERTINENT PART OF NON-LEGISLATIVE AUTHORITY:

A. Relevant Excerpts From Revenue Procedure 85-18, I.R.B. 1985-13, 27 (a non-legislative Internal Revenue interprative promulgation):

". . .SEC. 3. APPLICATION

.01 "Safe Haven" Rules

There are several alternative standards that constitute "safe havens" in determining whether a taxpayer has a "reasonable basis" for not treating an individual as an employee. . ."

". . .A taxpayer who fails to meet any of the three "safe havens" may nevertheless be entitled to relief if the taxpayer can demonstrate, in some other manner, a reasonable basis for not treating the individual as an employee. In H.R. Rep. No. 95-1748, 95th Cong., 2d Sess. 5 (1978), 1978-3 (Vol. 1) C.B. 629, 633, it is indicated that "reasonable basis" should be construed liberally in favor of the taxpayer."

". . ..09 Definition of Employee

For purposes of section 530(a) of the Act, the term employee means employees under sections 3121(d), 3306(i) and 3401(C) of the Code."